COHERENCE FOR DEVELOPMENT: ECONOMIC RECOMMENDATIONS FOR SPAIN[1]

Iliana Olivié
Real Instituto Elcano

According to the definitions and classifications gathered in the backgrounder, coherence in economic development policies implies that the economic policies – objectives and instruments –, created by donor countries and which have an impact on the socioeconomic development of recipient countries, must try to meet the development goals. These policies include measures concerning international trade, migrants' remittances, foreign direct investment (FDI), external debt and international financial architecture (IFA)[2].

There are many ways through which these flows or economic policies can have an impact – either positive or negative – on the development of aid recipient countries. In this sense, it must be said that the economic relations between developing and developed countries are quite complex. So are the conditions needed for a positive impact on the development of partner countries (see graph).

External economic relations and development

Recent experience shows that the necessary conditions for external trade to have a positive impact on a country's development and economic growth – considered as a step forward to meet the Millennium Development Goals (MDGs) – are basically three: (i) non-discriminatory economic insertion, which allows developing countries to take advantage of trade openness; (ii) access to markets of developed countries; (iii) development of exporting capacities – and thus productive capacities – in partner countries.

The IFA, understood as the set of measures aimed at keeping or achieving international financial stability and efficiency, also plays a relevant role when analysing coherence in policies, even if its is not usually included in this type of studies.

The IFA determines the volume, nature and frequency – both input and output – of foreign capital flows into developing countries, acting as a push factor, especially for the FDI and the debt of developing countries.

Also, due to the international financial stability goals, the IFA plays a determining role in the resolution as well as the birth and explosion of financial crisis in developing countries. It is linked to migrants' remittances which contain a counter-cyclical component since they are higher in times of crisis. The IFA also influences the developing countries' external debt due to either the increase in the existing debt or to the additional indebtedness with multilateral bodies within the framework of rescue plans.

---

[1] This text summarises the main ideas contained in Olivié and Sorroza (coordinators). *Coherencia para el desarrollo: recomendaciones para España en materia económica*, Elcano Reports, num. 5, June 2006.

[2] Even if this classification has tried to include the most relevant dimensions in economic relations between donors and receiving countries, it must be said that it might not tackle other important dimensions. We could cite, for instance, tax heavens which can play an important role in financing developing countries.

Other than a potential counter-cyclical effect, migrants' remittances also have a direct positive effect on income, which translates in a consumption increase, an investment increase or both. They also increase household incomes and enhance a country's overall development if they are spent on basic goods – such as food, clothing, shoes or other goods related to productivity of human capital – or invested in productive sectors related to basic needs such as housing.

The transient nature of remittances also affects their use in the recipient country. Those with temporary incomes may tend to spend less than those with permanent incomes. On the other hand, if family members of migrants perceive that flow as temporary, the tendency to invest will be higher.

However, if we want remittances to translate into high economic growth, especially development and poverty reduction, they will need to be included in a government's macroeconomic programme, as it happens with foreign trade and other flows tackled in this analysis. In this sense, there must be measures aimed at promoting development of financial markets which will facilitate higher investment levels.

FDI has traditionally been considered as one of the most benign sources of foreign investment in development, especially if it is compared to portfolio investments or to the different types of debt. Unlike these other types of investment, FDI seems to guarantee higher stability. However, if foreign investment is to translate into effective socioeconomic development, as considered in the Millennium Development Goals, certain conditions must be met.

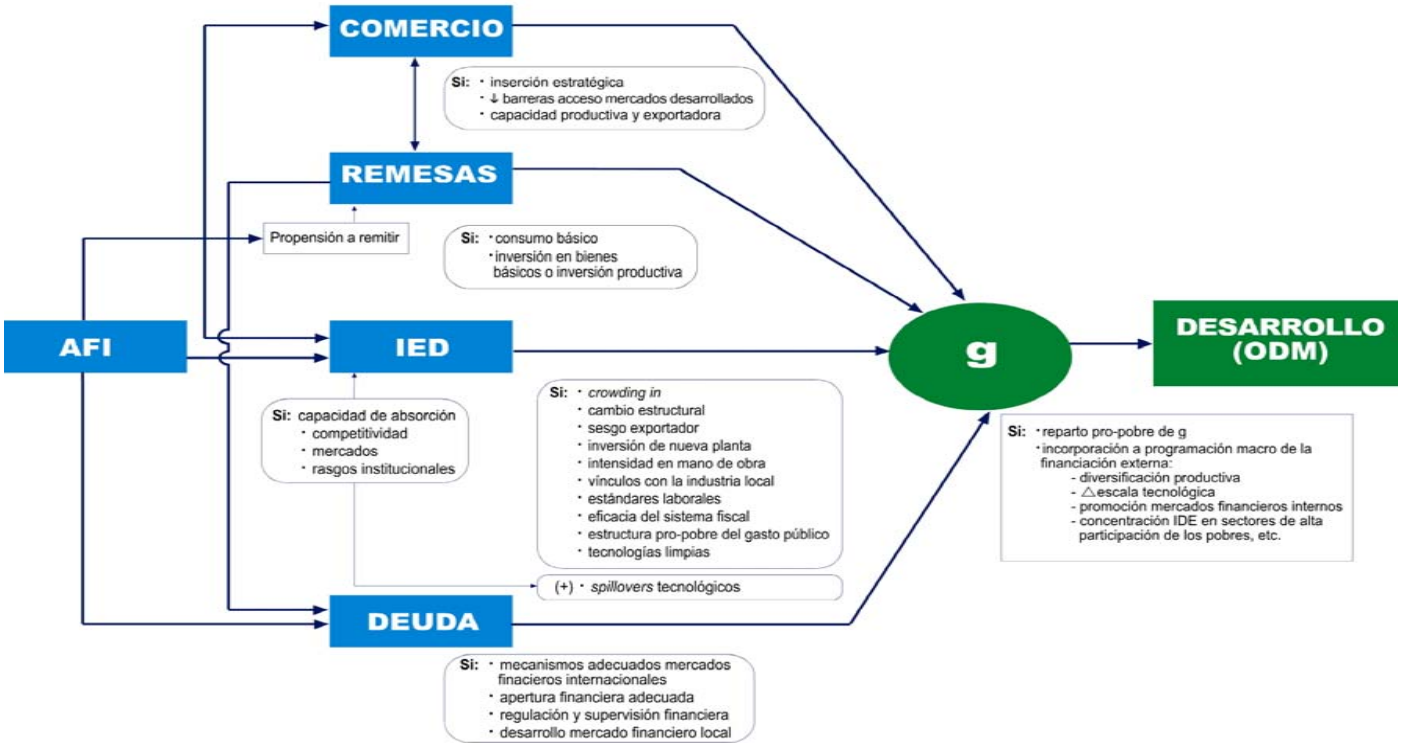
Firstly, the country must have the capacity to attract FDI and needs, therefore, to achieve certain levels of competitiveness – labour costs or, preferably, efficiency in other factors of production –, a certain market size or other institutional features such as a secure legal framework, trade openness, etc.

Once in the target country, the conditions for FDI to translate into higher levels of social and economic development are numerous (see graph). An example of this would be the creation of technological spillovers through subcontracts with local industries; the training, development or making of new products for the local market; or the creation of joint ventures. FDI can also have an impact on growth through the increase of the gross fixed capital formation (GFCF), only if it is through green field investment and not the result of a merger/purchase process. For the GFCF to increase there should be a crowding-in effect, which increases a country's economic activity, and not a crowding-out effect, which entails the elimination of local companies operating in the FDI host market. Also, if we want direct investment to translate into jobs in the host country there must be a high foreign investment in labour. Links with the local industries must also be created. This is the case of technological spillovers.

On the other hand, if FDI is to contribute to the Millennium Development Goals, that is, if it is to reduce poverty in its various forms, investment must require the use of factors of production (labour or land in some cases) which are accessible to the lower strata of society so that they can also participate.

Like the other financial flows contemplated in this analysis, the external debt allows for compensation of the domestic savings deficit, thus financing growth and development processes which could not otherwise be financed. There should be, however, a sustainable level of indebtedness. Under certain conditions, 'over-indebtedness' could lead to a financial crisis.

Potencial de las relaciones comerciales y financieras exteriores para los países en desarollo



From: Olivié and Sorroza (coordinators). *Coherencia para el desarrollo: recomendaciones para España en materia económica*, Elcano Reports, num. 5, June 2006.

Recommendations

This analysis puts forward a series of recommendations for higher coherence in economic policies for development. If these recommendations are to increase social and economic development, certain conditions concerning the five economic dimensions must be met.

As pointed out in different studies and reports, the potential benefits of international trade for developing countries will not be realised as long as developed countries do not substantially reform their agricultural support programmes. In such cases, however, there should be compensation mechanisms for problems related to food safety in less-developed countries which are net food importers. These problems would derive from an international food price rise. Other measures could include tariff reduction and respect for standards adopted in international fora, without neglecting anti-dumping measures, for instance.

The measures related to migrants' remittances that a donor country like Spain could apply should concentrate on the dissemination of information, that is, information on how to send money and how to use it in the target country. The measures could also include lowering costs of remittances as well as other technical assistance measures aimed at strengthening the recipient countries' financial system. In such cases, the donor country only has to provide the necessary incentives for remittances to be used in investments within productive sectors, which would have a wider impact on the country's social and economic development.

Some of the measures needed to achieve high consistency of FDI policies following the MDG only require a revision of criteria used for allocating public aid. These criteria should be adapted to the conditions needed for the productive flow to increase growth and development. Other measures could include binding provisions for transnational companies within international regulatory frameworks regarding direct investment.

As for the external debt of aid recipient countries, a lot of work needs still to be done, either through the Club of Paris or the Highly Indebted Poor Countries (HIPC) initiative, which tackle debt relief. There should also be other measures geared at preventing situations such as those of the highly indebted countries. Following this line, some proposals such as the Sovereign Debt Restructuring Mechanism (SDRM) – which allows for more equitable costs in case of non-payment of debt contracts between creditors and debtors – should be reconsidered.

While it is true that the set of measures in the IFA are not aimed at increasing the funding possibilities of developing countries, it must be said that many of these measures do affect the funding possibilities of aid recipient countries. In such cases, the financial norms, regulations, best practices or even the Basel II agreement should be adapted to the developing countries' funding systems. Also, it would be highly positive if some international agents – which due to their *modus operandi* can act as pro-cyclical factors in times of crisis – were obliged to widely disseminate information.

Other than the fields related to the economic dimensions analysed – trade, remittances, direct investment, debt and IFA – there are three other types of recommendations to take into account when analysing the coherence of economic policies with development.

Firstly, there are recommendations related to those policies working for international cooperation and development. Most of these recommendations are aimed at creating/offering technical assistance programmes for a strategic integration of aid recipient countries. Work should therefore be done on: encouraging productive and exporting capacities – as established on the 8th MDG –, developing the local funding systems – as discussed when dealing with the recommendations related to migrants' remittances –, preventing over-indebtedness' by offering technical assistance to central banks, or giving competitiveness of factors of production in order to attract higher levels of FDI[3]. The administrations of donor countries also have the possibility of offering their support in co-development by creating, for instance, specific programmes for migrants' families or by improving statistics on developing countries.

Secondly, the analysis above also shows that developing countries must at least have minimum levels of policy space which allows them to develop their plans or programmes depending on their own economic, political or social reality. It is therefore necessary to revise multilateral rules and procedures, such as the ones in the WTO today, which tend to homogenise international trade or investment regimes, usually producing a (not always strategic) liberalisation of economic flow.

And thirdly, there are the institutional recommendations. Those discussed so far try to give an answer to *what* is coherence and are an attempt to link the donor's economic instruments to the needs of recipient countries. If we want to know *how* we achieve coherence or how to apply these recommendations, we must look into the institutional aspects of donors' administrations. Measures range from the creation of a White Book for policy coherence to the improvement of coordination mechanisms within administrations. It must be said therefore that if we want higher policy coherence in donor countries, governments and administrations alike must make it a top political priority.

Foroaod – Spanish Development Aid

FRIDE organised the project "Spanish Development Aid - Mid-term Review and a Proposal for a Participative Consultation" between June 2006 and April 2007. This project aims to develop a consultation process about the current Spanish government's development cooperation policy. We have created a forum for participation and debate, in order to assess the Spanish development cooperation reform agenda and to identify the main achievements and shortcomings in operationalising the initiatives based on the principle of "More Aid, Better Aid". A set of recommendation guidelines were developed, through participative methods, with the objective of putting into practice the aspirations of the Spanish development cooperation policy.

www.foroaod.org

[3]When creating these programmes, the previous commitments related to sectoral allocations of aid should be taken into account. Such is the case of the 20/20 commitment, which obliges donors to allocate at least 20% of their aid funds to basic social needs.